(2)

No. 94-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ERICH E. and HELEN B. SCHLEIER,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether age discrimination in violation of the duty imposed by the Age Discrimination in Employment Act of 1967 is a tort-like personal injury, entitling victims to exclude settlement amounts from their gross income as "damages received . . . on account of personal injuries" under Section 104(a)(2) of the Internal Revenue Code.

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PRELIMINARY STATEMENT

The lawsuit against United Air Lines, Inc., that Mr. Schleier joined was a class action under the Age Discrimination in Employment Act of 1967 (the "ADEA"). Numerous members of that class action were subsequently challenged by the Commissioner of Internal Revenue with respect to their treatment of settlement amounts on their federal income tax returns. All of these individuals were represented, and continue to be represented, by counsel for Mr. and Mrs. Schleier in this case. These similarly situated, commonly represented individuals are referred to herein as the "Schleier Group."

The Commissioner of Internal Revenue has appealed decisions in favor of various members of the Schleier

Group to the respective United States Courts of Appeals for the Fifth, Seventh, Ninth, Tenth, Eleventh, and Federal Circuits.[1] In two of the decisions that have been reported thus far, the taxpayers are members of the Schleier Group. *See Schmitz* v. *Commissioner*, No. 93-70960 (9th Cir. August 30, 1994), *see* Pet. App.[2] at 78a-96a; *Bennett* v. *United States*, 30 Fed. Cl. 396 (1994), *appeal pending*, No. 94-5107 (Fed. Cir.).

COUNTER-STATEMENT OF THE CASE

In accordance with Rule 24.2, respondents limit their statement to the following clarifications.

1. Respondents agree with petitioner that a conflict now exists among the decisions of the Fifth, Seventh, and Ninth Circuit Courts of Appeals. This conflict extends to the Third and Sixth Circuit Courts of Appeals, to the extent that decisions in those circuits on the tax treatment of ADEA damages antedating *United States* v. *Burke*, 112 S.Ct. 1867 (1992), were not overruled by that case.

2. There is no basis in the record for accepting petitioner's unsubstantiated allegations that the issues in this case "affect many thousands of individuals who have received, *or will receive in the future*, damage awards under the ADEA and other state and federal statutory schemes,"

[1] In the cases of several members of the Schleier Group whose cases are being held in abeyance by the Tax Court, any appellate review would lie before the United States Courts of Appeals for the First and Second Circuits. *See McIver* v. *Commissioner*, No. 8814-90 (U.S. Tax Court), and *Clifford* v. *Commissioner*, No. 105-93 (U.S. Tax Court).

[2] References to "Pet. App." are to the Appendix attached to the Petition for A Writ of Certiorari.

Petition at 9 (emphasis added), or that the question in this case "affects countless individuals who have received, *or will receive*, monetary remedies under the ADEA and other state and federal statutory schemes," Petition at 16 (emphasis added). The applicability of the result in this case beyond the Schleier Group and the husband and wife in *Downey* v. *Commissioner*, 97 T.C. 150 (1991), *supp. op.*, 100 T.C. 634 (1993), *rev'd*, No. 93-3763 (7th Cir. August 30, 1994), is speculative. As to the possibility of other, comparable lawsuits, it is conjectural whether age discrimination actions spawning tax disputes will increase or whether they will decrease, inasmuch as federal tax cases have arisen out of only a minuscule number of all ADEA actions brought to date.[3] Any other cases raising the same issue of law as that of Mr. and Mrs. Schleier are limited to taxable years (i) before the effective date of the amendment by the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2379, (ii) for which the statute of limitations has not yet expired.

REASONS FOR DENYING THE WRIT

I.

THE DECISION OF THE FIFTH CIRCUIT COURT OF APPEALS CORRECTLY APPLIES THE STANDARDS SET FORTH IN *UNITED STATES* v. *BURKE*, AND THEREFORE PRESENTS NO ISSUE WARRANTING REVIEW.

Even in cases involving conflicting decisions among circuit courts of appeals, the acceptance of jurisdiction by the Supreme Court is an act of discretion. Rule 10.1.

[3] The first tax case applying Section 104(a)(2) to ADEA damages did not arise until two decades after the enactment of the ADEA. *See Rickel* v. *Commissioner*, 92 T.C. 510 (1989), *rev'd in part*, 900 F.2d 655 (3d Cir. 1990).

1. The petitioner implicitly argues that all decisions on the tax treatment of ADEA damages rendered before *United States* v. *Burke* are no longer good law. *See Rickel* v. *Commissioner*, 92 T.C. 510 (1989), *rev'd in part*, 900 F.2d 655 (3d Cir. 1990), *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990), and *Redfield* v. *Insurance Company of North America*, 940 F.2d 542 (9th Cir. 1991). However, in *Purcell* v. *Seguin State Bank & Trust Co.*, 999 F.2d 950 (5th Cir. 1993), the Fifth Circuit Court of Appeals relied upon this line of cases. *Accord*, *Schmitz*; *Bennett*. In *Reese* v. *United States*, 24 F.3d 228 (Fed. Cir. 1994), the Court of Appeals for the Federal Circuit cited and applied *Pistillo* and *Redfield* in order to distinguish exclusively punitive damages from damages that have a compensatory function. The majority opinion in *Burke* cited *Rickel* with apparent approbation and without qualification,[4] showing that the Court did not perceive itself as overruling that case. The decision of the court below continues the pre-*Burke* line of Section 104(a)(2) ADEA cases epitomized by *Rickel*, *Pistillo*, and *Redfield*.

2. Exclusion of age discrimination proceeds from gross income is consistent with *United States* v. *Burke*. That case harmonized the language of the Treasury Regulations ("tort or tort-type rights," 26 C.F.R. § 1.104-1(c)), with the words of the statute ("damages received . . . on account of personal injury," 26 U.S.C. § 104(a)(2)), by emphasizing the importance of a tort-like remedial scheme even in instances where "grave harm" to victims of discrimination may be presumed. 112 S.Ct. at 1872. *Burke* distilled two factors as a test of the essential elements of a personal injury action under Section 104(a)(2): (i) the

[4] *See* 112 S.Ct. 1871, n. 6.

spectrum of possible recoveries must include some redress that does more than restore the victim's lost wages, and (ii) the fact-finding process must provide the opportunity for a trial by jury.

The ADEA combines compensatory and punitive elements from the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.* ("FLSA"), including the provision for liquidated damages, which had previously been interpreted by this Court to connote "damages too obscure and difficult of proof for estimate other than by liquidated damages." *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 707 (1945) (citations omitted; emphasis added); *see, also, Overnight Motor Transp. Co., Inc.* v. *Missel*, 316 U.S. 572, 583-584 (1942). Using the FLSA as a model, Congress enacted the ADEA liquidated damage remedy in part[5] as a legislative substitute for a range of damages that were presumed to exist in individual cases but that—unlike the company-wide policy of discrimination in the instant case—could be proven only by prosecuting separate lawsuits on behalf of each of the affected victims. In contrast to the pre-1991 damages available under Title VII, which were confined to back pay, these additional damages from the perspective of the victim of age discrimination satisfy the *Burke* court's requirement for a range of damages beyond lost wages. *See Schmitz*, Pet. App. at 87a.

[5] As this Court recognized in *Trans World Airlines, Inc.* v. *Thurston*, 469 U.S. 111, 125-126 (1985), although liquidated damages under the FLSA were exclusively compensatory, Congress created a punitive role for liquidated damages under the ADEA by not carrying over the criminal sanctions from the FLSA into the ADEA and by allowing the double damage liability and its standard of willful violation to deter wrongdoers. However, the dual role of ADEA liquidated damages does not stand in the way of their satisfying the *Burke* test. *See Schmitz*, Pet. App. at 88a-89a.

The second factor highlighted by the Supreme Court in *Burke* is beyond question. Unlike Title VII before the 1991 amendments, the ADEA provides a right to jury trials. 29 U.S.C. § 626(c).

3. The *Downey* decision, on which petitioner relies, did not even mention the role of jury trials in *Burke*. In contrast, other post-*Burke* courts that have considered this issue have taken the Court's repeated references to jury trials more seriously. In so doing, they have concluded that the availability of jury trials under the ADEA is an additional consideration weighing in favor of the exclusion of ADEA damages. *See Schmitz*; *Bennett*.

The approach of the Seventh Circuit Court of Appeals under the ADEA is as flawed as its position under the Internal Revenue Code. Despite the clear teaching of this Court in *Trans World Airlines, Inc.* v. *Thurston*, 469 U.S. 111 (1985), the appeals court stated as the partial basis for its reversal of the Tax Court:

> This court adheres to the position that ADEA liquidated damages replace prejudgment interest.

Downey, Pet. App. at 76a. Such an exclusively compensatory interpretation cannot be reconciled with the conclusion of the Supreme Court in *Thurston*, where it was held that ADEA liquidated damages play a punitive role for purposes of the standard of willfulness under the ADEA.

By contrast, the Ninth Circuit Court of Appeals, whose decision in *Criswell* v. *Western Airlines Inc.*, 709 F.2d 544 (9th Cir. 1983), *aff'd on other grounds*, 472 U.S. 400 (1985), anticipated the conclusion of this Court in *Thurston*, recently emphasized in *Schmitz* that damages under the ADEA have a dual role, when considered comprehensively from the standpoints of the tortfeasor and the victim. *See Schmitz*, Pet. App. at 88a-89a. The compensatory rule of

ADEA liquidated damages from the perspective of the victim satisfies *Burke*'s need for a tort-like breadth of remediation. *Id.*

Given that the *Downey* case is the only appellate decision in conflict with the holdings in the Third, Fifth, Sixth, and Ninth Circuits, it is also questionable whether the issue has sufficiently ripened for review by the Supreme Court.

II.

THE SUPREME COURT SHOULD DECLINE TO ADOPT THE COMMISSIONER'S LITIGATING POSITION UNDER SECTION 104(A)(2) AS A BASIS FOR GRANTING CERTIORARI AS LONG AS THE COMMISSIONER FAILS TO FORMALIZE HER POSITION THROUGH RULEMAKING OR OTHER APPROPRIATE ADMINISTRATIVE PROCEEDINGS.

In the interest of judicial economy, it is not appropriate to resort to a case-by-case adjudication through prolonged circuit conflict, if the litigating agency can streamline the process through unilateral administrative practice.

There are currently at least three separate interpretations of Section 104(a)(2) emanating from the Internal Revenue Service. The first is the view of the Treasury Regulations, promulgated almost forty years ago and never modified in this respect, which link the existence of a personal injury to the presence of "tort or tort-type rights." 26 C.F.R. § 1.104-1(c). The second is the administrative interpretation set forth in Rev. Rul. 93-88, 1993-41 I.R.B. 4, which attempts to apply the *Burke* framework to Title VII of the Civil Rights Act of 1964, as amended in 1991, 42 U.S.C. § 2000e *et seq.*, to 42 U.S.C. § 1981, and to the Americans With Disabilities Act, 42 U.S.C. §§ 12101-12213. The third is the litigating position of the Commissioner

in the *Schleier*, *Downey*, and *Schmitz* cases. However, petitioner's litigating position cannot easily be reconciled with her administrative position, or with the absence of clarifying regulations.

Any suggestion that *Burke* precludes extension of the Section 104(a)(2) exclusion to statutes that redress economic injuries conflicts with Revenue Ruling 93-88, which accorded tax-free treatment to those components of a damage payment that by definition do nothing other than compensate for back pay:

> Compensatory damages, including back pay, received in satisfaction of a claim of disparate treatment gender discrimination under Title VII . . . as amended in 1991, are excludable from gross income as damages for personal injury . . . *even if the compensatory damages in such a case are limited to back pay.*

See 1993-41 I.R.B. at 5 (emphasis added). Indeed, even traditional tort compensation consisting of back pay or lost wages would be taxable under the suggestion that remedies redressing economic injuries fall outside the exclusion of Section 104(a)(2). The litigating theory of the petitioner would then be at odds with the regulation's rationale of "tort or tort-type rights," which has been interpreted to allow exclusion for lost wages or other economic losses. *Threlkeld* v. *Commissioner*, 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988).

Petitioner's position in this case would also suggest a bifurcation of damage awards between taxable and nontaxable components, reminiscent of the dichotomy between "professional" and "personal" damages that was rejected by *Roemer* v. *Commissioner*, 716 F.2d 693 (9th Cir. 1983), and *Threlkeld* v. *Commissioner*, *supra*, both of which were cited by the *Burke* majority. *See* 112 S.Ct. at 1871,

n. 6. However, bifurcation has been rejected by the Internal Revenue Service. *See* Rev. Rul. 93-88, *supra*, at 5.

"Deference to what appears to be nothing more than an agency's convenient litigating position would be entirely inappropriate." *Bowen* v. *Georgetown University Hospital*, 488 U.S. 204, 213 (1988). In the instant case, the various positions of the agency do not represent a coherent legal theory that will assist courts in resolving the cases of those individuals who have received, or will receive, monetary remedies under the ADEA and other state and federal statutory schemes. On the contrary, they are mutually inconsistent and provide no stable platform from which to apply the law.[6] If the Commissioner is serious in wishing to provide innumerable taxpayers with guidelines for applying the doctrine of *Burke*, she can take the first step by promulgating regulations in accordance with the Administrative Procedure Act, 5 U.S.C. § 551 *et seq.*, supplemented as appropriate by administrative announcements.[7] Until that happens, this Court should decline petitioner's invitation to displace the regulatory and administrative process by granting certiorari on the basis of a litigating position of the Commissioner that has been adopted for this case.

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[6] The petitioner's conception of liquidated damages also displays a lack of coherence. In support of the proposition that "Liquidated damages are not a tort remedy; they are an ordinary remedy for breach of contract," the petition cites *Rex Trailer Co.* v. *United States*, 350 U.S. 151 (1956). Petition at 13, n. 9. However, that case arose under the Surplus Property Act of 1944 and has nothing to do with either the FLSA or the ADEA. Any similarity begins and ends in the names of the remedies.

[7] Five years after the 1989 amendment to Section 104(a)(2) made by the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2379, no form of administrative guidance on its new standard has been issued.

III.

THE ISSUE IN THIS CASE, WHICH AROSE UNDER PRE-1989 TAX LAW, MAY BE LIMITED ONLY TO OPEN TAX YEARS BEFORE THE AMENDMENT TO SECTION 104(A)(2) ENACTED BY THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989, THEREBY HAVING LITTLE CONTINUING SIGNIFICANCE.

Petitioner asks the Court to provide, among other things, prospective guidance for taxpayers who will be subject to Section 104(a)(2) as it was amended by the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2379. Petition at 16. Yet, as petitioner concedes, "[t]he proper interpretation of the 1989 amendment is . . . not at issue in the present case, which . . . involves [a] tax return which preceded the 1989 amendment." Petition at 14, n. 10. Moreover, if the Court decides Mr. and Mrs. Schleier's case in a way that does not reach beyond the pre-1989 statute, petitioner's need for prospective guidance disappears as a justification for granting certiorari.

The amendment to Section 104(a)(2) adopted in 1989 started out as a more comprehensive provision that would have taxed all damages in nonphysical injury cases, whether punitive or compensatory. *See* H.R. Rep. No. 101-247, 101st Cong., 1st Sess. at 1354-1355, *reprinted in* 1989 U.S. Code, Cong. & Admin. News at 2824-25. However, the bill that emerged from conference, which is reflected in current Section 104(a)(2), resolved only the tax treatment of "punitive damages in connection with a case not involving physical injury or physical damage." 26 U.S.C. § 104(a)(2).

The characterization of personal injury damages as "punitive" is not necessarily dispositive or even relevant under the pre-1989 version of Section 104(a)(2) applicable to Mr.

and Mrs. Schleier. *Compare Horton* v. *Commissioner*, No. 93-1928 (6th Cir. August 29, 1994) (punitive damages in tort case, held excludable under Section 104(a)(2)), *with Hawkins* v. *Commissioner*, No. 93-15828 (9th Cir. July 19, 1994) (punitive damages in tort case, held not excludable), *and Reese* v. *United States*, 24 F.3d 228 (Fed. Cir. 1994) (punitive damages in tort case, held not excludable). If this Court grants the petition, it is conceivable that it could resolve the pre-1989 tax treatment of age discrimination damages by finding that, irrespective of whether ADEA liquidated damages are exclusively punitive, the ADEA remedial framework is still sufficiently tort-like to bring ADEA damages within the scope of the Section 104(a)(2) exclusion.

The petitioner seems to be dissatisfied with the majority opinion in *Burke* because this Court did not adopt a broad, quasi-regulatory rule that would dispose of cases beyond the Title VII dispute then at issue. Apparently also dissatisfied with the limited scope of the 1989 amendment to Section 104(a)(2), petitioner has pursued the individual members of the Schleier Group in as many circuits as are necessary to create a conflict. Coordinated, circuit-directed litigation against a national group is almost guaranteed to produce a conflict among courts.[8]

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[8] The demographic spread of the Schleier Group permits a determined appellant to use this Court as an alternative to legislative amendment. If "p" represents the probability that an appellate court will affirm the lower court, then the probability of appellant's succeeding in creating a circuit conflict is "$1 - p^{12} - (1 - p)^{12}$," assuming access to 12 circuit courts of appeals and further assuming independence of courts. *See* Feller, *Introduction to Probability Theory and Its Applications*, v. 1, at 27 (3d ed. 1968). Even if p were as high as .9, representing a very strong pre-disposition to rule in favor of the appellee-taxpayer, an appellant with resources and opportunity could pursue the issue in all circuits with a probability in excess of 70% of creating a conflict.

Rejecting invitations to judicial activism in other contexts, this Court has recognized that the more responsible course may be to refrain from remaking the law, thereby inviting Congressional action on a problem of nationwide significance. *See, e.g., Quill Corp.* v. *North Dakota*, 112 S.Ct. 1904, at 1916 (1992) (footnote omitted): "[T]he underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." The Court should exercise a similar restraint here, where Congress is better poised to adopt guidance of a prospective nature, on which future taxpayers may rely in settling their lawsuits.

In the alternative, if the Commissioner does not want to wait for Congressional or regulatory clarification in this area, but wishes to secure a judicial decision, then the more efficient test case to provide prospective guidance is not Mr. and Mrs. Schleier's, which arose under pre-1989 law, but a set of facts governed by the current statute.

CONCLUSION

The Petition sets forth no compelling basis for review by this Court, since the Fifth Circuit's disposition, as amplified by the Ninth Circuit in *Schmitz* v. *Commissioner*, is consistent with previous decisions of this Court, while *Downey* v. *Commissioner* is demonstrably inconsistent. In addition, giving any consideration to the litigating position presented by the Commissioner of Internal Revenue in the Schleier Group cases (or in other pending pre-1989 cases) is inappropriate until the Commissioner of the Internal Revenue Service has removed any possible incon-

sistencies in her various administrative positions or Congress has enacted clear guidelines. The Petition should be denied.

Respectfully submitted,

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